

# Sacralizing the Market? The Role of DSN–MUI in the Legal-Economic Legitimacy of Islamic Banking in Indonesia

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Agus Fakhрина\*<sup>1</sup> and Abdul Hamid<sup>2</sup>

<sup>1,2</sup>Faculty of Sharia, Universitas Islam Negeri K.H. Abdurrahman Wahid Pekalongan,

✉ Author Corresponding: [agus.fakhрина@uingusdur.ac.id](mailto:agus.fakhрина@uingusdur.ac.id)\*

## Abstract

This study explores the complex interplay between religion and economic rationality in the legitimization of Indonesia's Islamic banking industry. Focusing on the legal authority of the National Sharia Board–Indonesian Ulama Council (DSN–MUI), the research critically examines how fatwas and regulatory accommodations enable Islamic banks to replicate conventional banking practices in pursuit of accelerated growth. Using a qualitative documentary analysis of DSN–MUI fatwas and Indonesia's banking regulations, the study finds that the DSN–MUI increasingly adopts an accommodative stance by employing *istihsān bi al-'urf wa al-maṣlahah* (juristic preference based on custom and public interest) to legitimize practices favorable to Islamic banks. While this approach facilitates rapid institutional development, it also raises concerns over the convergence between Islamic and conventional banking models, potentially diluting the normative distinctiveness of Islamic finance. These findings contribute to the broader discourse on Sharia governance, regulatory pragmatism, and the political economy of Islamic finance in Muslim-majority contexts.

## Abstrak

Studi ini menganalisis keterkaitan antara dimensi keagamaan dan rasionalitas ekonomi dalam proses legitimasi industri perbankan syariah di Indonesia. Dengan menitikberatkan pada peran otoritatif Dewan Syariah Nasional–Majelis Ulama Indonesia (DSN–MUI), penelitian ini mengevaluasi secara kritis bagaimana fatwa dan kebijakan regulator digunakan untuk membenarkan praktik-praktik perbankan syariah yang menyerupai sistem konvensional demi mendorong pertumbuhan yang lebih cepat. Melalui analisis dokumen kualitatif terhadap fatwa DSN–MUI dan regulasi perbankan nasional, temuan menunjukkan bahwa DSN–MUI semakin menunjukkan pendekatan akomodatif dengan menggunakan *istihsān bi al-'urf wa al-maṣlahah* (preferensi hukum berdasarkan kebiasaan dan kemaslahatan) sebagai dasar legitimasi syariah terhadap kebijakan yang mendukung kepentingan bank syariah. Pendekatan ini memang mempercepat perkembangan industri, namun sekaligus menimbulkan kekhawatiran atas semakin hilangnya distingsi normatif antara bank syariah dan bank konvensional. Temuan ini memperkaya wacana kontemporer mengenai tata kelola syariah, kompromi regulatif, dan ekonomi politik keuangan Islam di negara mayoritas Muslim.

## Keywords:

Religion; economy; *istihsān*; legitimacy; accommodative

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## Introduction

Islamic banks in Indonesia tend to develop products that bear a strong resemblance to those of conventional banks, thereby creating the perception that there is minimal distinction between the two types of financial institutions (Risalah, 2023). The actions taken by the Islamic bank are undoubtedly based on legitimacy that can justify or convince its actions. In a business context, legitimacy refers to the extent to which profit-making actions undertaken by an Islamic bank align with the system of norms, values, beliefs, and definitions that are socially constructed within a given society (Alam & Miah, 2024; Islam et al., 2021; Rendtorff, 2020; Suchman, 1995). Furthermore, Islamic banks are financial institutions that adhere to the principles set forth in Islamic teachings in the conduct of their business activities (Jan et al., 2021; Khaleequzzaman et al., 2019; Ramazanovna et al., 2022; Saeed et al., 2023; Tatiana et al., 2015). The quality of religious guarantees can enhance the credibility of Islamic banks (Haridan et al., 2018). On the other hand, when the religious legitimacy of Islamic banking products is questioned, their credibility decreases (Azmat et al., 2021; Jouti, 2021). Consequently, Islamic banks consistently endeavor to secure Islamic legitimacy, given that Islamic law represents a pivotal element within Islamic banking, particularly for patrons who favor Islamic banking products (Alasfour, 2020).

Islamic banks are required to obtain approval or legitimacy from a sharia board before they can engage in any business activities (Abubakar Siddique et al., 2023; Fatmawati et al., 2022; Meslier et al., 2020; Mukhibad et al., 2023). In Indonesia, the National Sharia Board - Indonesian Ulama Council (DSN-MUI) plays a pivotal role in providing such approval. It is an authoritative religious institution that issues fatwas on Islamic finance and economics in Indonesia, as regulated in Law No. 21 of 2007 concerning banking. Consequently, the actions of the Islamic bank are inextricably linked to the legitimacy conferred by DSN-MUI. It would be beneficial to undertake a study of the manner in which DSN-MUI provides legitimacy to the actions of Islamic banks that prefer to imitate conventional banks.

The question of religious legitimacy for Islamic banking has been addressed in studies examining the role of *hiyal* in the development of Islamic financial products. These include studies by Mansoori (2011), Khaleequzzaman et al. (2016), al-Khulūfī (2010), and Fakhriina (2022). While these studies address the religious legitimacy of profit creation in Islamic banks, they primarily concentrate on the legitimacy of the utilization of *hiyal* in the advancement of Islamic financial products. Consequently, there is a dearth of research examining the legitimacy accorded by DSN-MUI to the actions of Islamic banks that tend to emulate conventional banking institutions.

This study is of considerable importance as it seeks to critically assess the validity of the arguments employed by DSN-MUI to support its approval. The results of this study will likely serve to rectify any discrepancies in the approval process. This is a critical factor in the development of Islamic banking in Indonesia. Moreover, the market share of Islamic banks in Indonesia remains modest despite the country's predominantly Muslim population. The limited market share of Islamic banks may be attributable to their perceived similarity to conventional banks. This potential similarity may result in a decline in interest from prospective customers, who may perceive Islamic banks as analogous to conventional banks, as previously discussed.

## Method

It is important to note that the fatwa of DSN-MUI is not isolated; rather, it is influenced by banking regulations in Indonesia. To address these issues, the fatwa of DSN-MUI and Indonesia's banking regulations were subjected to a comprehensive and detailed examination as the primary data source. An analysis was conducted to identify and examine the fatwas that provide a foundation for the legitimacy of the actions of Islamic banks that opt to emulate

conventional banks and related sharia banking regulations. The underlying rationales of these fatwas were also analyzed. Furthermore, books and scientific journals were utilized as secondary data sources. The data were then subjected to analysis in three stages. The initial stage of the process involved editing, which entailed rewriting the primary legal materials obtained in the form of fatwas of DSN-MUI and secondary legal materials in the form of writings by Ma'ruf Amin, who served as the former Chairman of the Indonesian Ulama Council (MUI) from 2015 to 2019.

Additionally, related scientific books and journals were incorporated into this stage. The objective was to ensure completeness and to present the information in a concise and accessible format through the use of simple sentences. Secondly, the materials were subjected to a systematic selection process, after which they were classified and compiled systematically and logically. Thirdly, a description of the research results was provided based on the legal materials obtained, which were then subjected to analysis (Bachtiar, 2019). A methodological approach involving Qualitative Content Analysis (QCA) was employed for the data analysis.

### The Approval of Income Smoothing

Our investigation of the fatwas of DSN-MUI revealed that those indicating approval of the actions of Islamic banks, which are more akin to conventional banks in determining profits, pertain to income smoothing and the recognition of time value as the basis for recognizing and reducing profits in *murābaḥah* financing. The fatwa pertaining to income smoothing is Fatwa No. 87/DSN-MUIIXII/2012, which addresses the Income Smoothing Method for Third Party Funds. The fatwa related to the recognition of time value as the basis for recognizing profits and reducing profits in *murābaḥah* financing is Fatwa No. 84/DSN-MUI/XII/2012 concerning the method of recognizing *tamwīl bi al- murābaḥah* profits (*murābaḥah* financing) in Islamic financial institutions and Fatwa No. 153/DSN-MUI/VI/2022 concerning the settlement of *murābaḥah* financing debts before maturity.

In Fatwa No. 87/DSN-MUIIXII/2012, DSN-MUI approved the income smoothing method that Islamic banks have practiced. This approval extends to both the income smoothing method without forming a profit adjustment reserve and the income smoothing method by forming a profit adjustment reserve (Profit Equalization Reserve/PER). In this fatwa, income smoothing is defined as the arrangement of recognition and reporting of profit or income from time to time by withholding part of the profit/income in one period and transferring it to another period with the aim of reducing excessive fluctuations in profit sharing between Islamic financial institutions and depositors (third party funds). In the absence of a profit adjustment reserve, Islamic banks may release their rights to customers when the distributed business results are below the projected level. This is done to adjust the rewards for Third Party Fund customers to ensure competitiveness. Conversely, the income smoothing method with funds forming a profit adjustment reserve permits Islamic banks to set aside profits in excess of the projected return level for the purpose of regulating income and return levels for customers prior to distribution.

In the field of economics, the term income smoothing is used to describe the process of reducing fluctuations in reported earnings over time (Ozili, 2019). This approach enables banks to mitigate the volatility of their profits by reducing high profits in favorable years and increasing low profits in unfavorable years. This strategy allows them to achieve a more stable and predictable trajectory of profits over time while also mitigating the inherent volatility of their financial condition (Lubis et al., 2021; Ozili, 2019). As a component of earnings management, this methodology is frequently utilized to facilitate a comprehensive evaluation of the company's financial performance (Lubis et al., 2021). Income smoothing is the most frequently utilized method by management for the purpose of managing profits derived from

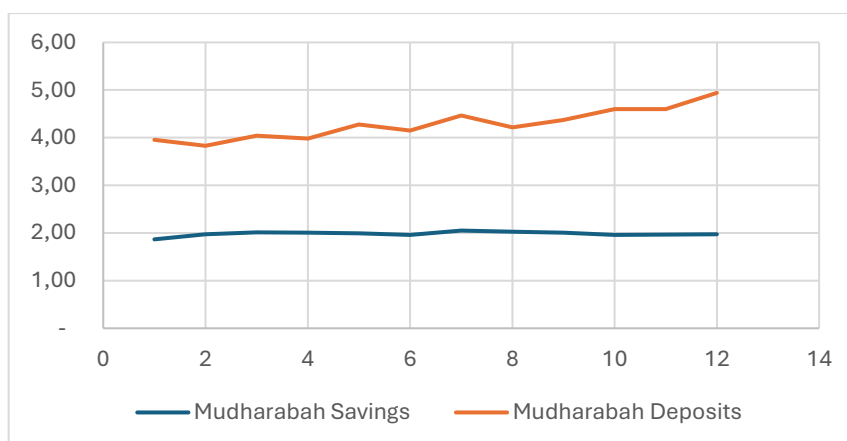
accounting manipulation policies, as opposed to the other three methods of earnings management, namely, taking a bath, income minimization, and income maximization (Lubis et al., 2021). A total of 116 sharia stock companies and 43 non-sharia stock companies in Indonesia were identified as engaging in income smoothing practices (Mardiani et al., 2023), and a review of eleven Islamic banks in Indonesia revealed that five of them were engaged in income smoothing practices (Iskandar et al., 2022). This behavior is typically observed to increase in conjunction with heightened market orientation and the advancement of the financial system. Conversely, it tends to diminish when robust investor protection, rigorous accounting transparency, limitations on banking operations, and comprehensive supervision are put in place (Fonseca & González, 2008). This behavior will contribute to the stability of the company's profits.

Income smoothing represents a deliberate act of manipulation by management designed to influence the perception of a company's profitability. By artificially fluctuating profits, management can report a level of profitability that is perceived as normal (Lubis et al., 2021; Ozili, 2019), which can facilitate unethical actions (Iskandar et al., 2022). Nevertheless, DSN-MUI has given its approval for the income smoothing method to be employed by Islamic banks (Iskandar et al., 2022). DSN-MUI employs a set of considerations to evaluate the suitability of income-smoothing methods. These considerations are designed to ensure that the rewards offered to Third Party Fund customers are competitive and able to anticipate potential risks associated with the transfer or withdrawal of customer funds from Islamic banks. This is due to the possibility of displacing commercial risk, as outlined in Fatwa No. 87/DSN-MUIIXII/2012 concerning the income smoothing method for Third Party Funds.

Furthermore, the fatwa indicates that DSN-MUI approves the use of profit projections that are realized in the form of equivalent rates by Islamic banks. The fatwa contains a clause that explicitly authorizes the use of projections: "Islamic Financial institutions may establish a Profit Equalization Reserve (PER) to anticipate the possibility of profit-sharing distributions to depositors below the projected return rate".

This quote illustrates that Islamic banks may utilize profit-sharing projections in savings products to facilitate the formation of reserve funds as a contingency in the event that the actualized profit-sharing for customers falls below the projected return level. It is not uncommon for Islamic banks to promote their savings products in conjunction with profit-sharing projections or equivalent profit-sharing rates. In establishing the profit-sharing rate for their savings products, they emulate the interest rates of savings products in conventional banks (Kusuma et al., 2018). A review of Islamic banks in Indonesia reveals that nearly all of them utilize a benchmarking model to determine the profit-sharing ratio. Only a few banks have not adopted this practice. All three of these banks, namely Bank Syariah Mandiri, Bank Negara Indonesia Syariah, and Bank Rakyat Indonesia Syariah, which have since been incorporated into Bank Syariah Indonesia, as well as Bank Tabungan Negara Syariah, have acknowledged that they utilize benchmarking to ascertain the pricing of their *muḍārabah* savings products, with the aim of aligning them with the prevailing rates observed in conventional banking institutions. In establishing the profit-sharing ratio for their savings products, they emulate the interest rate of savings products in conventional banks (Kusuma et al., 2018).

The following is a graph of the equivalent rate data for *muḍārabah* savings and deposits of Islamic banks, as issued by the Financial Services Authority in 2023 (Otoritas Jasa Keuangan, 2024):



**Figure 1.**  
**Graph of Equivalent Rate of *Mudharabah* Savings and Deposits of Islamic Banks**

The graph illustrates that Islamic banks maintain that the rewards provided to depositors are within a relatively stable range, exhibiting minimal fluctuations. The profit rate of *mudharabah* savings ranges from 1.87 to 2.05, while the profit rate of *mudharabah* deposits ranges from 3.83 to 4.94.

### The Approval of the Time Value

The 2012 fatwa (No. 84/DSN-MUI/XII/2012) explicitly indicates the consensus regarding the utilization of the annuity method in recognition of the margin associated with *murabahah* financing. The fatwa (No. 84/DSN-MUI/XII/2012) provides a clear definition of the annuity method as a method of recognizing margins that are carried out proportionally on the remaining amount of the principal that has not been billed. This is done by multiplying the percentage of the margin by the remaining amount of the principal that has not been billed (*al-athman al-mutabaqqiyah*). The annuity method is a method of recognizing profits whereby the principal installment pattern increases in line with the period while the margin installment decreases in line with the period. However, the monthly installments remain consistent from the outset to the conclusion of the period (Cahyandari & Hasanah, 2023). This method has previously been a standard practice among conventional banks based on interest rates. This method is inextricably linked to the fundamental concept of the time value of money, which illustrates the relationship between time and financial value. The concept posits that money received at the present moment is inherently more valuable than money received at a future point in time (Amir et al., 2015; Siswanto, 2021).

In the view of DSN-MUI, the annuity method represents the optimal approach for Islamic banks that are in their growth phase. This perspective aligns with that of banking practitioners, who have indicated that this method can help to maintain bank liquidity and has the potential to impact bank management and sustainability significantly (Amir et al., 2015; Hosen et al., 2017). The approval granted by DSN-MUI was met with criticism from academic quarters, who asserted that the annuity method employed in the recognition of profits in *murabahah* financing was not in accordance with sharia principles, as it was deemed to be tantamount to usury (Amir et al., 2015; Mukhlisin & Hudaib, 2014; Siswanto, 2021). This approach is regarded as less aligned with the concept of *maṣlahah* in Islam, as it carries greater risk and may result in Islamic banks deviating from their Islamic values and reputation (Amir et al., 2015; Hosen et al., 2017).

The approval of the annuity method, which is based on the fundamental concept of the time value of money, is reinforced by the issuance of Fatwa No. 153/DSN-MUI/VI/2022



concerning the settlement of *murābahah* financing debt prior to its maturity. In this fatwa, DSN-MUI concurs with the proposition that Islamic banks should take account of the time value in *murābahah* financing and, indeed, that this is a mandatory requirement. This fatwa stipulates that the total remaining price that must be paid by the customer as the buyer when paying off the *murābahah* financing debt before maturity is *qīmah ḥālliyah* (the price at the time of settlement before maturity) minus the installments that have been paid. The issuance of this fatwa is a direct response to the numerous disputes that have arisen between customers and Islamic banks regarding the calculation of the remaining debt to be paid when seeking to settle *murābahah* financing before its maturity date. This is evidenced by the fatwa's consideration of the practice of paying off financing debts before maturity, which has resulted in disputes between customers and Islamic banks. Consequently, on August 2, 2021, DSN-MUI was compelled to facilitate a peaceful resolution of the problem. The issuance of this fatwa provides clarity regarding the calculation of debts that must be paid before maturity.

The issuance of this fatwa was met with approval from the Islamic banking industry. Even the Financial Services Authority published a guideline for Islamic banking *murābahah* financing products, which included a simulation of calculating the amount of the price that must be paid when the customer pays it off before maturity based on the annuity method (Departemen Perbankan Syariah Otoritas Jasa Keuangan, 2023). The following is a simulation made by the Financial Services Authority (Otoritas Jasa Keuangan, 2023):

**Table 1.**  
**Simulation Table of *Murābahah* Installment**

Month	Principal	Margin	Installments	Remaining Principal	Remaining Margin	Credit
-	-	-	-	100,000,000	24,000,000	124,000,000
1	3,369,063	1,797,604	5,166,667	96,630,937	22,202,396	118,833,333
2	3,429,625	1,737,042	5,166,667	93,201,312	20,465,354	113,666,667
3	3,491,276	1,675,391	5,166,667	89,710,036	18,789,964	108,500,000
4	3,554,035	1,612,631	5,166,667	86,156,001	17,177,333	103,333,333
5	3,617,923	1,548,744	5,166,667	82,538,078	15,628,589	98,166,667
6	3,682,959	1,483,708	5,166,667	78,855,119	14,144,881	93,000,000
7	3,749,164	1,417,503	5,166,667	75,105,955	12,727,378	87,833,333
8	3,816,559	1,350,108	5,166,667	71,289,396	11,377,271	82,666,667
9	3,885,166	1,281,501	5,166,667	67,404,230	10,095,770	77,500,000
10	3,955,006	1,211,661	5,166,667	63,449,225	8,884,109	72,333,333
11	4,026,101	1,140,566	5,166,667	59,423,124	7,743,543	67,166,667
12	4,098,474	1,068,192	5,166,667	55,324,650	6,675,350	62,000,000
13	4,172,149	994,518	5,166,667	51,152,501	5,680,832	56,833,333
14	4,247,147	919,519	5,166,667	46,905,354	4,761,313	51,666,667
15	4,323,494	843,173	5,166,667	42,581,860	3,918,140	46,500,000
16	4,401,213	765,453	5,166,667	38,180,646	3,152,687	41,333,333
17	4,480,330	686,337	5,166,667	33,700,316	2,466,350	36,166,667
18	4,560,868	605,798	5,166,667	29,139,448	1,860,552	31,000,000
19	4,642,855	523,812	5,166,667	24,496,593	1,336,740	25,833,333
20	4,726,315	440,352	5,166,667	19,770,278	896,388	20,666,667
21	4,811,275	355,391	5,166,667	14,959,003	540,997	15,500,000

22	4,897,763	268,904	5,166,667	10,061,240	272,093	10,333,333
23	4,985,805	180,861	5,166,667	5,075,434	91,232	5,166,667
24	5,075,430	91,236	5,166,667	0	0	0

Source: Department of Islamic Banking, Financial Services Authority, 2023

### **Maslahah and Sacralizing the Market**

The consensus on income smoothing and time value is predicated on the assumption that Islamic banks can effectively compete with their conventional counterparts as a consequence of the dual banking system policy, as enshrined in Law Number 1998 concerning Banking (Ali et al., 2023). This condition prompts Islamic banks to emulate conventional banks in their calculation of profits to be distributed to depositors, thereby ensuring consistency in their financing practices (Nugraha et al., 2023). In a dual banking system business environment, the ability of businesses to reject customer preferences for the benefits they desire is limited (Saeed et al., 2023; Sekreter et al., 2012). In contrast to the preference for compliance with Sharia law, there is a greater inclination towards aligning with the customer's preferences (Bakhouché et al., 2022; Saeed et al., 2023).

Despite the fact that the majority of Indonesians adhere to the Islamic faith, a considerable proportion of the population tends to gravitate towards conventional banking institutions, operating under the assumption that Islamic and conventional banking are the same. The Islamic environment of the dual banking system does not necessarily prompt individuals to select Islamic banking institutions (Bakhouché et al., 2022; Nugraha et al., 2023; Widarjono & Rafik, 2023). Consequently, Islamic banks implement income smoothing as a strategy to mitigate displaced commercial risk. This occurs when Islamic bank depositors transfer their funds to conventional bank deposits when conventional bank deposit interest rates increase in a dual banking system environment (Sulong & Mohd Noor, 2018; Widarjono et al., 2022). The rate determination is demonstrated to adhere to the conventional norms of bank interest rates (Ercan et al., 2021; Kusuma et al., 2018; Saeed et al., 2023; Sekreter et al., 2012).

This condition facilitates DSN-MUI's decision to approve. DSN-MUI has indicated a preference for providing Islamic legal solutions when legal issues are identified in Islamic financial transactions that are to be legalized in Islamic banking (Amin, 2017). From their perspective, Islamic law should be presented in a flexible and non-burdensome manner, particularly in order to facilitate the growth of the Islamic economy. This economy must adopt existing conventional finance in order to align with Sharia principles (Amin, 2017). Ma'ruf Amin has proposed that DSN-MUI should apply the legal maxim "*al-akhdu bi arjaḥ al-aqwāl wa al-aṣlah in amkana, wa illā fa al-aṣlah*" (if possible, take the stronger and more beneficial opinion; but if not, then the more beneficial opinion is used) more frequently in its decisions, with a particular focus on the consideration of *maṣlahah* (Amin, 2020).

DSN-MUI is primarily concerned with aligning Islamic law with economic principles. This is evident in the Council's inclination to adhere to the recommendations of economic experts. DSN-MUI has taken controversial steps. As previously stated, the approval process has been the subject of controversy within DSN-MUI. The approval of income smoothing is regarded from a business ethics perspective as an unethical practice that may lead to corruption, given that it constitutes manipulation.

Meanwhile, the approval of the application of the annuity method in recognizing profits represents a form of recognition of the concept of the time value of money in relation to usury, which is explicitly prohibited in Islamic teachings. The primary objective of DSN-MUI is to facilitate the growth and development of Islamic banking in Indonesia. Consequently, any measure is endorsed with the objective of facilitating the growth, advancement, and competitiveness of Islamic banking institutions vis-à-vis their conventional counterparts,

which have long enjoyed a dominant position in the financial sector. To this end, arguments deemed to be pertinent are duly advanced.

DSN-MUI's primary approach in responding to legal issues for which they have been asked for a fatwa is to provide a legal solution rather than merely stating whether the legal issue of the proposed transaction is haram, permissible, or something else. They prioritize the provision of legal solutions that align with Sharia principles, often utilizing the *hiyal* method as a *makhārij fihiyyah* approach to direct contract arrangements (Fakhrina, 2022). Alternatively, the four rules introduced by Ma'ruf Amin (*al-taysīr al-manhajī, tafrīq al-halāl 'an al-harām, i'ādah al-naẓar, and taḥqīq al-manāf*) may be applied (Amin, 2017). Accordingly, in addressing each legal issue for which a fatwa is sought, DSN-MUI endeavors to identify a suitable legal resolution guided by the arguments deemed most pertinent.

In general, DSN-MUI employs a variety of sources in its fatwas, including verses of the Qur'an, Hadith, Ijma' (if applicable), legal maxim, opinions of scholars (when appropriate), fatwa of fatwa institutions (when relevant), and the Accounting and Auditing Organization for Islamic Financial Institutions (when pertinent). These sources serve to reinforce the Council's arguments. Of the numerous arguments presented, the utilization of legal maxims is particularly noteworthy, given DSN-MUI's inclination towards *maqāṣid al-sharīah* (*maṣlaḥah*). Legal maxims are rules developed by scholars of Islamic jurisprudence to regulate legal issues. Legal maxims may serve as a foundation for legal experts, muftis, and judges in formulating prudent legal judgments, irrespective of whether such decisions align with *maqāṣid al-sharīah*. This approach ensures the continued viability and profitability of this enterprise in the long term while respecting the competitive nature of the legal market (Abd Rahman et al., 2020; Amanullah, 2018; Busari et al., 2022; Mansoori, 2013; Rosly et al., 2000; Zakariyah, 2012).

In the fatwa on income smoothing, seven legal maxims are presented that imply that income smoothing is permitted as long as there are no elements that make it prohibited. These elements include taking the rights of others and the necessity of income smoothing for the benefit of the individual. The decision of DSN-MUI is based on the benefit to the individual. In the fatwa regarding the annuity method, eight legal maxims imply that the annuity method for recognizing *murābaḥah* financing profits is permitted, provided that it has become a customary practice carried out by Islamic banks. The decision of DSN-MUI is clearly based on the benefit. It is a decision that cannot be disputed, given that DSN-MUI is an authoritative fatwa institution in the field of Islamic finance. In the fatwa regarding pre-maturity repayment, four legal maxims imply that providing a discount on *murābaḥah* financing debt based on time value is permitted, provided that it has become a customary practice and is viewed favorably by Muslims.

The decision of DSN-MUI in approving the use of income smoothing seems to prioritize the use of *istiḥsān bi al-maṣlaḥah* as a legal argument. *Istiḥsān bi al-maṣlaḥah* is a theory of how Islamic law can be revised for reasons of *maṣlaḥah* (Johari et al., 2023; Sodiqin, 2021). DSN-MUI has amended the provisions of the *muḍārabah* contract, stipulating that the profit sharing given to customers is not to be distributed in its entirety. This allows Islamic banks to regulate the recognition and reporting of profits or income on an ad hoc basis by withholding a portion of the profit/income in one period and transferring it to another period, with the aim of reducing excessive fluctuations in profit sharing between Islamic financial institutions and depositors (third party funds). Regrettably, DSN-MUI's approach to *maṣlaḥah* appears to be biased in favor of Islamic banks and their interests rather than being aligned with the broader societal and economic welfare. The *maṣlaḥah* in question is a collective *ijtihād* that, given the broad nature of the concept of *maṣlaḥah*, is susceptible to misapplication. This indicates a need for further study regarding the overall impact of this decision (Eldersevi & Haron, 2020).



A closer examination of income smoothing reveals a potential violation of the *maqāṣid al-sharīah*, which requires transparency in information, particularly regarding profits obtained by Islamic banks. This is necessary to ensure the emergence of justice. Furthermore, the practice of income smoothing is rife with elements of fraud and ambiguity. In the context of *maqāṣid al-sharīah*, there are no explicit provisions delineating the permissible forms of profit management within the framework of Islamic law. Regardless of the underlying motivation, this practice is not in accordance with Islamic teachings because it tends to result in actions that benefit one party while harming the other, thereby introducing an element of fraud (Lubis et al., 2021; Muliasari & Dianati, 2019; Obid & Demikha, 2011; Putra & Widayani, 2019; Nadilla, 2022). In lieu of income smoothing, Islamic banks would be better served by implementing regulations such as Sarbanes-Oxley to the fullest extent, with robust supervision and control, and integrating Islamic business ethics into their corporate governance structures to mitigate the potential for fraud (Lubis et al., 2021; Muliasari & Dianati, 2019).

In parallel, the annuity method is imbued with a capitalistic ethos that is analogous to usury. As is widely recognized, conventional accounting and finance permit the calculation of interest in three distinct methods: the flat, effective, and annuity interest methods. These methods are predicated on the fundamental assumption that time and money are inextricably linked. Discussing annuities is inextricably linked to the concept of basic time value. The term time value of money denotes the relationship between time and money, whereby money received at the present moment is considered to be of greater value than money received at a future point in time. The present value is always less than the future value because interest is generated and accumulated from the present value to a future date. In determining the future value using the accumulation process, the calculation is carried out moving against time using the discounting process (Amir et al., 2015).

The decision of DSN-MUI in approving the annuity method also appears to prioritize the use of *istiḥsān* as a legal basis, particularly the application of *istiḥsān bi al-'urf wa al-maṣlaḥah* (juristic preference based on custom and public interest). The theory of *istiḥsān bi al-'urf wa al-maṣlaḥah* posits a methodology for revising Islamic law in accordance with prevailing customs and the greater public interest (Johari et al., 2023; Sodikin, 2021). This implies that the approval is founded upon the customs that have been established by Islamic banks, with the objective of facilitating their growth, development, and competitiveness vis-à-vis conventional banks.

The *maṣlaḥah* constructed by DSN-MUI is a *maṣlaḥah* for Islamic banks rather than a *maṣlaḥah* for the broader community. DSN-MUI's primary objective is to ensure the survival of Islamic banks in the context of competition with conventional banks rather than to address the needs of the broader community. Indeed, the term *maṣlaḥah* is associated with the public interest rather than being confined to specific groups within society, such as financial institutions. In fact, according to al-Shātibī, based on the legal maxim, "if there is a conflict between *maṣlaḥah* carried out by a few people/individuals and a large group, then the latter will win" (Raisūnī, 1995; Rifqi & Thahir, 2019). The theory of *maṣlaḥah* necessitates the harmonization of diverse interests and priorities with the objective of optimizing societal benefits (Ariyanti & Supani, 2024; Turnip et al., 2024). Moreover, any *'urf* that contradicts the *nuṣūṣ al-sharī'ah* is wholly rejected (al-Zuhaylī, 1986; Zulkifli et al., 2024). One example is the *'urf* of borrowing money (qard) with interest, which is categorically rejected on the basis that it contradicts the text of sharia, which prohibits usury (al-Zuhaylī, 1986). However, it appears that DSN-MUI places a greater emphasis on the *maṣlaḥah* for Islamic banks as evidence, thereby neglecting to ascertain whether the *'urf* that Islamic banks typically observe falls within the purview of the *'urf* that is *fāsid*.

This suggests that DSN-MUI, in its capacity as a religious authority, has assumed the role of serving the Islamic banking industry, which represents the economy. In this context,

DSN-MUI is intensifying its efforts to serve the economy with its slogan of legal solutions. At the outset, DSN-MUI did not explicitly regulate income smoothing and the annuity method. However, in subsequent developments, it began to regulate these practices by approving both. This recalls the history of how the Church, as a representative of religion, initially prohibited interest but subsequently appeared to legitimize it (Rendtorff, 2020).

The actions of DSN-MUI are inextricably linked to its role as an authoritative fatwa institution within the domain of Islamic finance and economics in Indonesia. According to Law No. 21 of 2007 concerning Banking, Islamic financial institutions are obligated to adhere to Sharia principles stipulated by MUI. These principles are subsequently incorporated into Bank Indonesia Regulations. Consequently, DSN-MUI is obligated to address the challenges posed by Islamic banking regulations, which are influenced by social, economic, and political dynamics. This ensures that Islamic law does not conflict with these regulations (Hidayah et al., 2024). The issuance of Fatwa No. 87/DSN-MUIIXII/2012 concerning the income smoothing method for third-party funds is inextricably linked to Bank Indonesia's policy, which stipulates that Islamic banks must implement risk management in accordance with Bank Indonesia Regulation No. 13/23/PBI/2011 concerning the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units, which was issued in 2011 (Nur Aini, 2012). This policy was adopted in recognition of the tendency among customers to allocate their financial resources to institutions that offer higher returns. A substantial body of research has emerged that suggests the implementation of a dual banking system, as observed in Indonesia, does not inherently motivate individuals to opt for Islamic banking institutions (Bakhouche et al., 2022; Nugraha et al., 2023; Widarjono & Rafik, 2023). A notable phenomenon that has been observed in the financial sector is the tendency of Islamic bank depositors to convert their funds into conventional bank deposits when interest rates on conventional bank deposits exhibit an upward trend (Sulong & Mohd Noor, 2018; Widarjono et al., 2022). In this context, the role of DSN-MUI becomes imperative, as it is entrusted with the responsibility of approving the policies implemented by Bank Indonesia.

DSN-MUI faces a considerable challenge in mitigating the discord between religious principles, which prioritize altruism and adherence to Sharia tenets, and economic interests, which often prioritize material gain and the satisfaction of human desires. DSN-MUI's deliberations on *maṣlaḥah* must aspire to achieve a balanced perspective between these two principles (Amin, 2011). According to the predominant perspective among scholars of Islamic jurisprudence, including al-Ġazālī and al-Shātibī, any benefit must be aligned with the objectives of sharia, even if it is not aligned with human interests. This phenomenon can be attributed to the fact that human benefit is not invariably aligned with the precepts of Sharia but, rather, is frequently influenced by the pursuit of sensual desires (Aslati et al., 2024; Syamsuar et al., 2024). Consequently, the sharia's fundamental principles, rather than the individual's aspirations, serve as the benchmark for determining benefits.

In light of this, DSN-MUI has outlined a series of stipulations in its fatwa, as articulated in Fatwa No. 87/DSN-MUIIXII/2012 and Fatwa No. 84/DSN-MUI/XII/2012, with the objective of ensuring that the *maṣlaḥah* principle is aligned with the tenets of sharia. In Fatwa No. 87/DSN-MUIIXII/2012, DSN-MUI delineates six conditions. Initially, a reserve fund may be established through the allocation of profits prior to distribution, contingent upon the realization of profits that surpass the projected return rate and the acquisition of third-party fund customers' consent. Secondly, the reserve fund constitutes the collective right of third-party fund customers. Fourthly, the utilization of income smoothing is permissible exclusively for Islamic financial institutions in circumstances where there is a high degree of suspicion regarding the existence of displaced commercial risk. The fifth issue to be addressed pertains to the implementation of the income smoothing method policy. It is imperative to note that this policy may not be executed in instances where it is observed to result in undisclosed usury

practices characterized by the provision of rewards without duly considering the attainment of tangible outcomes. Sixthly, in the context of implementing the income smoothing method without reserves, it is pertinent to note that when the business results shared are lower than the projection, Islamic banks may exercise the prerogative to relinquish their rights to adjust the rewards for third-party fund customers. This strategic decision is undertaken with the objective of maintaining competitiveness within the industry and is communicated to the relevant customers. According to Fatwa No. 84/DSN-MUI/XII/2012, the annuity method is employed in the recognition of *murābahah* financing profits when Islamic financial institutions are in a period of growth.

The legal solution proffered by DSN-MUI is a manifestation of an accommodative approach. This approach is characteristic of the mainstream of Islamic economics, which is dominant in the development of Islamic finance on a global scale (Iqbal, 2024). This school is willing to accept conventional economic thinking and make it an economy that is in accordance with sharia (Iqbal, 2024). In Malaysia, a significant proportion of sukuk is issued and traded based on a combination of *bay' al-ʿinah* and *bay' al-dayn*. Despite the fact that these two contracts are only permitted by the Shāfiʿī Madhhab and prohibited by the majority of ulama, the Shariah Advisory Council of Bank Negara Malaysia (SACBNM) still allows them (S. S. Razak et al., 2019). The SACBNM also has authorized the use of *al-tawarruq al-munazzam* and *bay' al-ʿinah* for the development of deposit products (Bank Negara Malaysia, 2010; Zulkepli & Mohamad, 2019) even though the fact that both are opposed by numerous world fatwa institutions, including the International Islamic Fiqh Academy (IIFA) and the Islamic Fiqh Assembly of the Muslim World League (IFAMWL) (Razak, 2014). Both of them emphasize more on formal aspects, while Sharia objectives are ignored which can give rise to prohibited debt interest (Maksum, 2023; Razak, 2014; Zulkepli & Mohamad, 2019). This is a form of accommodating economic interests.

The DSN-MUI approach is employed to support the interests of Islamic banks, thereby facilitating their rapid growth. In this particular instance, DSN-MUI employs *istiḥsān bi al-ʿurf wa al-maṣlaḥah* (legal preferences grounded in custom and benefit) as the foundational principle for the legitimacy of sharia with regard to the aforementioned regulatory framework. Suchman's perspective posits that the accommodative approach to the interests of Islamic banks constitutes a form of pragmatic legitimacy (Suchman, 1995). Pragmatic legitimacy is a form of legitimacy that is predicated on the calculation of the personal interests of the audience closest to an organization (Suchman, 1995). This suggests that the legitimacy bestowed by the DSN-MUI is contingent upon the interests of customers, who, as the primary beneficiaries of Islamic banking, are in a direct and continuous relationship with Islamic banks. In this relationship, Islamic bank customers tend to be constituents who examine the behavior of Islamic banks to determine the practical consequences for them of each line of Islamic bank activity. This legitimacy is further solidified through an exchange legitimacy framework, whereby support for Islamic banking policies is contingent upon the anticipated benefits these policies provide to customers. Consequently, the utilization of *istiḥsān bi al-ʿurf wa al-maṣlaḥah* by DSN-MUI has undergone a shift towards prioritizing customer interests. This evolution signifies a transformation in the role of *istiḥsān*, which has transitioned from a legal flexibility instrument to a regulatory justification mechanism. As previously indicated, the implementation of the income smoothing method constitutes a component of Bank Indonesia policy, as delineated in Regulation No. 13/23/PBI/2011 concerning the Implementation of Risk Management for Sharia Commercial Banks and Sharia Business Units. This regulatory framework pertains to the application of risk management in Islamic banking institutions, with the objective of facilitating their accelerated growth. Despite the fact that the income smoothing method is contrary to the fundamental principles of the *muḍārabah* contract, DSN-MUI employs the concept of *istiḥsān bi al-ʿurf wa al-maṣlaḥah* to rationalize the policy. This

principle is similarly applied to justify the application of the annuity method in recognizing *murābahah* financing profits. *Istihsān* is a form of argument that is employed to ensure the flexibility of Islamic law and to avoid undue hardship for Muslims as a whole. However, within the context of Islamic banking, it is employed to serve the economic interests of both regulators and business actors (Islamic banks) as well as customers.

This principle is similarly applicable to the utilization of other legal arguments, as evidenced by the cases of *sadd al-dharī'ah* and *istiṣlāḥ*. This principle is further elaborated in Fatwa No. 08/DSN-MUI/IV/2000 concerning Mushārahah Financing and No. 07/DSN-MUI/IV/2000 concerning *Muḍārabah* Financing (Qiradh), which stipulates that Islamic banks can request collateral. It is important to note that both *muḍārabah* and *mushārahah* contracts are classified as *amānah* contracts (trust-based contracts). A fundamental aspect of *amānah* contract is the prohibition of collateral. This is an instance of the utilization of *sadd al-dharī'ah* and *istiṣlāḥ* in the legitimization of regulations. This is due to the fact that the allowance of collateral in both financing is intended to circumvent any potential deviations by customers and to ensure the optimal outcome for Islamic banks. The following assertion serves as a foundation for the regulation that stipulates the necessity of collateral in financing transactions, as delineated in Law No. 10 of 1998 and Law No. 21 of 2008 concerning Islamic Banking. Indeed, DSN-MUI establishes additional regulations that permit Islamic banks to request collateral for all categories of financing, as outlined in Fatwa No. 92/DSN-MUI/IV/2014 concerning Financing Accompanied by Rahn. In Islamic law, collateral in a transaction is applicable only to the *rahn* contract. This regulation is applicable to *murābahah* financing, defined as a sale and purchase contract. This phenomenon naturally gives rise to a transition from a sales to a service transaction, thereby rendering the initial transaction legally invalid (Hidayah et al., 2021).

The steps of DSN-MUI related to the income smoothing method and the annuity method may facilitate the growth of the Islamic banking industry and enhance its competitiveness vis-à-vis conventional banks. However, they may also contribute to a growing awareness among the public that Islamic banks and conventional banks are no longer distinguishable. The profit sharing they receive on their savings or deposits is not significantly different from that offered by conventional banks. Indeed, it would appear that the profit sharing is identical to that offered by conventional banks. Similarly, the installments paid by customers for *murābahah* financing are calculated in a manner that is consistent with that of conventional banks. The legitimacy of profit-sharing arrangements is contingent upon the provision of leniency through income smoothing agreements and annuity methods. Consequently, the profit-sharing offered to customers can be considered a form of pseudo-profit-sharing, while the margin charged to customers can be regarded as a pseudo-margin. This phenomenon represents a form of market sacralization by DSN-MUI. This suggests that the Islamic financial market is regarded as sacred (*shar'ī*) due to the utilization of contracts that have been modified and legitimized by DSN-MUI. This step has given rise to concerns regarding the increasing erosion of the normative distinction between Islamic banks and conventional banks.

## Conclusion

DSN-MUI, in its capacity as a representative of religion, serves the interests of Islamic banks, which represent the economy. This observation indicates that the relationship between religion and the economy is one in which religion serves the economic interests of the nation. The approval given to the distribution of profits in *muḍārabah* contracts and the recognition of profits in *murābahah* contracts is more based on *istiḥsān bi al-maṣlaḥah* and *istiḥsān bi al-'urf*, which is more in favor of Islamic banks. DSN–MUI increasingly adopts an accommodative stance by employing *istiḥsān bi al-'urf wa al-maṣlaḥah* (juristic preference based on custom

and public interest) to legitimize practices favorable to Islamic banks. While this approach facilitates rapid institutional development, it also raises concerns over the convergence between Islamic and conventional banking models, potentially diluting the normative distinctiveness of Islamic finance. These findings contribute to the broader discourse on sharia governance, regulatory pragmatism, and the political economy of Islamic finance in Muslim-majority contexts. In the future, further research is necessary to ascertain the socio-economic ramifications of the agreement. This research will facilitate the development of a more robust argument for amending the agreement to promote the growth of superior Islamic banks.

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